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Federal Communications Commission

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Testimony of Kathryn L. Haycock, Panelist
President and CEO
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Mesa, AZ
(Vice Chairman, Competitive Telecommunications Association)

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Statement of
KATHRYN L. HAYCOCK
President and CEO, Call-America
Mesa, Arizona

Federal Communications Commission
Forum on Small Business Market Entry Barriers
September 24, 1996

Panel I: Market Barriers Affecting Small Businesses Generally

Good afternoon. My name is Kathy Haycock. I am President and Chief Executive Officer of Call-America, a long distance company based in Mesa, Arizona. I also presently serve as Vice Chairman of the Competitive Telecommunications Association (CompTel), which represents nearly 200 competitive telecommunications service providers, the vast majority of whom have annual revenues of less than $10 million.

In 1982, two years before the divestiture of the Bell System, I pioneered competitive long distance in Arizona when I founded Call-America. A dental hygienist with four small children, I had no prior experience in telecommunications. When I decided to enter the long distance marketplace, I tried to obtain financing from traditional lending institutions. Like many other small entrepreneurs in the long distance industry, I was turned down. As a last resort, I mortgaged my family home to finance my company.

Today, I am proud to say that Call-America is competitive with the large national facilities-based carriers in our service area. The company provides a complete array of high-quality, low-cost long distance services to 25,000 business and residential customers within Arizona.

Unique Telecommunications Obstacles

Call-America depends totally upon the incumbent local exchange carrier (ILEC) for access to our existing and potential customers. This relationship distinguishes my business from the real estate business or virtually any retail industry, and is a market entry barrier unique to telecommunications. It poses the risk of placing companies like mine at a significant competitive disadvantage.

I decided to enter the long distance marketplace as the result of the FCC's decision authorizing WATS resale. Call-America was the first reseller in the State of Arizona.

The playing field in 1982 was far from level. By virtue of its monopoly status, Mountain Bell (now U S WEST) enjoyed tremendous market power and a host of unfair competitive advantages. It controlled the signalling, the network, and access to every customer in Arizona. This resulted in a number of competitive disadvantages:

- ***1+ Dialing:*** Although Mountain Bell's affiliate, AT&T, was able to provide customers with 1+ long distance dialing, Mountain Bell refused to provide dialing parity to competitors.

- ***Signalling:*** Mountain Bell refused to give new long distance competitors the signalling that it furnished to its subsidiary AT&T. Without this signalling, which includes such vital information as the number of the party placing the call, the number of the called party and whether or not the called party answered the telephone, long distance competitors were forced to incur significant expense to devise their own systems to recreate this information.

- ***Enhanced Features:*** To compete with AT&T, companies like Call-America had to use computers that could read touch-tone signals, thus limiting customers solely to those with touch-tone telephones. A Call-America customer needed to dial a series of numbers (consisting of at least twenty-three digits) which identified, via a personal identification number, who was placing the call and the number of the party the customer wished to reach. The opportunity for fraud and abuse was enormous. Consequently, small competitors lost hundreds of thousands of dollars through the use of this primitive system.

- ***Answer Supervision:*** Since Mountain Bell refused to forward the information which verified when the called party had picked up the telephone, long distance competitors could not accurately determine if or when to start billing a long distance call. Although a telephone is often answered by the first or second ring, Call-America was forced to give away sixty seconds on each and every phone call. Customers were instructed to let the telephone ring no longer than seven times, or they could be charged inadvertently for a completed phone call.

- ***Engineering:*** Mountain Bell also refused to give Call-America and other competitors the same high quality connections that it provided AT&T. We were not given the opportunity to request the engineering specifications necessary to assure quality. As a result, the long distance competitors suffered a bad reputation for poor quality, including static, echo and low volume. This problem was so severe that, even today, many customers have the erroneous perception that alternative carriers to AT&T provide a discount because they provide inferior service quality.

Trying to compete under such severe competitive disadvantages was difficult. Even when divestiture occurred in 1984, conditions did not improve immediately. It was not until 1985, when the Bell monopolies implemented equal access pursuant to the directives of the FCC and the Department of Justice, that all long distance companies began to be provided with service equal in price, quality and type to that which is provided to AT&T. For the first time, small long distance competitors had an opportunity to compete against AT&T on a relatively level playing field.

Small long distance carriers continued to face occasional discriminatory practices because of their size even with the implementation of equal access. For example, Call-America initiated a billing dispute with U S WEST. For many months, U S WEST refused to provide billing records to justify its invoices and threatened on many occasions to discontinue service. When the call detail was finally obtained after well over a year, it was easy to document that U S WEST had been charging Call-America two and three times for a single call. Although Call-America received credit for U S WEST's overbillings, it never recovered the thousands of dollars and hundreds of hours spent trying to resolve the dispute. It is doubtful that the larger carriers encountered such dilatory tactics, which may have resulted in some small companies going out of business.

Prospective Local Market Barriers

As the FCC ponders how best to bring competition to the nation under the 1996 Telecommunications Act, it is critical that it understand the limitations unique to small telecommunications companies that *still* exist today. The same monopoly bottleneck which controlled the early long distance competitors' access to their own customers still exists. When customers pick up a telephone to place long distance calls, they are not directly routed to their carrier of choice. Instead they are routed to the nearest ILEC end office. The ILEC is responsible for then routing the call to the appropriate long distance carrier, along with the signalling necessary to complete that call. ILECs also control many other critical features necessary to complete long distance or local calls, including but not limited to proprietary customer information, the billing system and provisioning.

New, competitive providers who enter the local service market under the market-opening provisions of the 1996 Act face the *same* bottleneck disadvantages that the long distance industry has labored under since divestiture. For the foreseeable future, new entrants will be forced to rely on ILECs to bring customers from their home or business to the first ILEC switch for interconnection. With the ILEC as a direct competitor, controlling necessary functions such as signalling and sole access to the customer, the potential for anti-competitive abuse remains enormous.

For example, around the latter part of 1987, Call-America found that U S WEST was adding up to twelve additional seconds to all Call-America messages in certain end offices. We discovered this discrepancy as a result of joint testing which was conducted at our request between the Call-America and U S WEST switches. It was only detected because U S WEST, in this instance, agreed to cooperate with Call-America. Because of the razor-thin margins in the long distance market, this problem would have severely disadvantaged Call-America as a competitor had it not been caught and had the Regional Bell Operating Company (RBOC) not cooperated in its detection.

There are countless abuses that could occur *without* detection to deter local competition, when ILECS will *not* have the incentive to behave in a cooperative fashion. The problem will be compounded if the RBOCs are allowed into competitive markets prematurely, creating an additional incentive to engage in anti-competitive behavior. The FCC must ensure that RBOCs cannot use their monopoly power against new local competitors *before* they are allowed into competitive businesses such as long distance. The FCC has made great strides toward this end in its recent Report and Order implementing the local competition provisions of the 1996 Act. This "carrot" hopefully will incent the RBOCs to not use their monopoly advantages against competitors in the local service arena.

While anti-competitive practices will disadvantage all new local exchange entrants, including AT&T, MCI, and Sprint, the smaller companies lack the financial resources to engage in costly litigation and/or regulatory proceedings. As a result, they may be forced out of business if subjected to anti-competitive abuse. As long as the potential for monopoly abuse exists, smaller companies, especially those who already have experienced historical anti-competitive abuses, may be discouraged from entering the local marketplace.

Capital and Credit Barriers

As Vice Chairman of CompTel, I also am familiar with the difficulties many of my competitors face in obtaining the capital and credit to start their businesses, or to pursue acquisition or growth opportunities. As a rule, bigger companies have better borrowing power. Because of their size, they are able to arrange financing from equipment manufacturers and financial institutions more easily, at better interest rates, and on more favorable terms and conditions.

In contrast, small companies often are subject to high deposit requirements and installation charges when purchasing equipment. They routinely are overlooked by larger companies in forming strategic alliances, because of the erroneous view that we bring nothing to the table. And in financing transactions, their corporate officers often are required to forego the protection of corporate status. It is not uncommon for small business owners to be required to waive personal liability limitations, pledge their family homes, or sign personal guarantees. (I'm sure most in this room will agree that Bob Allen probably never is asked to do this on behalf of AT&T!)

Barriers to Facilities Construction

In my opinion, providing local service is not an option, it is a necessity for small companies. If the Bell Companies are able to offer "one stop shopping" to their customers, we must be able to do the same. Although small companies do not have the vast financial resources or access to capital required to build extensive facilities-based networks, if allowed they can compete very effectively as a reseller of existing facilities or as a purchaser of unbundled network elements.

To use the highly competitive interexchange carrier (IXC) industry as an example, although there are only four nationwide facilities-based IXC networks, over 500 long distance companies compete for the consumer's business wholly or partly by resale. Consumers have benefitted not only in dramatically decreased long distance rates, but in an explosion of enhanced services, features and technological advancements, including the development of fiber optics.

It will take time and a great deal of resources to duplicate local networks, bringing additional connections to every home and business. That is why it is so important that the FCC require the RBOCs and other ILECs to provide access to unbundled network elements on a nondiscriminatory basis, at cost-based rates, in a manner that permits companies like Call-America and others to combine and use these elements in any way they choose.

The establishment of fair, reasonable wholesale rates for the resale of ILEC retail services is also essential. Indeed, the only opportunity for small long distance companies like Call-America to be able to provide local and long distance services to their customers is through an economically rational resale regime. If a carrier wishes to resell an ILEC's existing retail services, it must be permitted to do so at prices which are discounted by the cost of *all* services and functions assumed by the reseller. The new rules will play a pivotal role in ensuring that all carriers, including resellers, have an opportunity to serve their customers in a competitive environment.

Regulatory Market Entry Barriers

Financial constraints common to small businesses have restricted Call-America's growth in the Arizona long distance market and also precluded its expansion outside the state. The cost of doing business in multiple states if each state were to establish its own individual guidelines for local competition would be enormous. Small companies, in particular, lack the financial and human resources to negotiate and comply with multiple regulatory requirements. Call-America cannot afford the transactional, legal and regulatory costs required to conduct business under a patchwork system of regulation by 50 individual states. I applaud the FCC's wisdom in mandating national rules for local service entry. This will ensure the establishment of an open, free, and competitive marketplace, which will not create costly regulatory obstacles favoring large companies.

Additionally, discriminatory pricing schemes such as unrestricted volume discounts which favor the largest companies must not be allowed. ILEC attempts to keep their largest access customers satisfied through the offering of non-cost justified volume discounts has been a recurring problem. Call-America and other small competitors have never opposed price differences that are based on differences in the underlying costs of providing services; however we are adamantly opposed to any volume or other discounts that are not cost-based.

Conclusions

The limitations and unique needs of the small telecommunications business sector must be considered at each juncture by the Commission. Vigilance on the part of federal and state regulatory authorities since the divestiture of AT&T has enabled companies such as Call-America to compete in the long distance arena profitably and on a level playing field. Unless the FCC and state regulatory commissions exert similar oversight and enforcement authority in local services, I fear that history will repeat itself, to the detriment of small competitive carriers. Once our objective of a completely open, fully competitive local service market is achieved, the ongoing need for telecommunications regulation will disappear.

We stand on the threshold of a new competitive telecommunications era. If local competition is allowed to develop, if fair rules are established to create a level playing field, not only will small telecommunications companies flourish, but American consumers will benefit as well.